Consolidated Financial Statements

Clarian Health Partners, Inc. and subsidiaries
Years Ended December 31, 2007 and 2006
With Report of Independent Auditors

Clarian Health Partners, Inc. and subsidiaries

Consolidated Financial Statements

Years Ended December 31, 2007 and 2006

Contents

Ernst & Young

Ernst & Young LLP
111 Monument Circle, Suite 2600
P.O.Box 44972
Indianapolis, Indiana 46204-2094

Phone: (317) 681-7000
Fax: (317) 681-7216
www.ey.com

Report of Independent Auditors

The Board of Directors
Clarian Health Partners, Inc.

We have audited the accompanying consolidated balance sheets of Clarian Health Partners, Inc. (an Indiana nonprofit corporation) and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the management of Clarian Health Partners, Inc. and subsidiaries. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of Clarian Health Partners, Inc.'s internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Clarian Health Partners, Inc.'s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Clarian Health Partners, Inc. and subsidiaries at December 31, 2007 and 2006, and the consolidated results of their operations and changes in their net assets and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

March 4, 2008

	December 31 2007	2006
Liabilities and net assets		
Current liabilities		
Accounts payable and accrued expenses	**$ 227,710**	$ 205,011
Accrued health claims	**33,916**	31,801
Salaries, wages, and related liabilities	**100,148**	86,291
Estimated third-party payor allowances	**33,265**	24,824
Current portion of long-term debt	**29,541**	29,466
Total current liabilities	**424,580**	377,393
Noncurrent liabilities		
Long-term debt, less current portion	**1,441,338**	1,445,638
Interest rate swaps	**5,237**	6,446
Accrued pension obligations	**18,668**	30,780
Accrued medical malpractice claims	**50,083**	41,899
Other	**11,508**	11,969
Total noncurrent liabilities	**1,526,834**	1,536,732
Total liabilities	**1,951,414**	1,914,125
Net assets		
Unrestricted	**1,963,967**	1,760,407
Temporarily restricted	**38,448**	38,113
Permanently restricted	**34,348**	28,405
Total net assets	**2,036,763**	1,826,925
Total liabilities and net assets	**$ 3,988,177**	$ 3,741,050

See accompanying notes.

Clarian Health Partners, Inc. and subsidiaries
Consolidated Statements of Operations and Changes in Net Assets

(Thousands of Dollars)

	Year Ended December 31 2007	2006
Revenue:		
Net patient service revenue	**$ 2,412,588**	$ 2,088,522
Member premium revenue	**294,809**	293,162
Other revenue	**106,485**	96,633
Total operating revenue	**2,813,882**	2,478,317
Expenses:		
Salaries, wages, and benefits	**1,175,570**	1,089,336
Supplies, drugs, purchased services, and other	**1,058,091**	861,354
Health claims to providers	**168,145**	175,659
Depreciation	**164,851**	152,953
Provision for uncollected patient accounts	**150,514**	121,717
Interest	**47,191**	47,335
Total operating expenses	**2,764,362**	2,448,354
Operating income	**49,520**	29,963
Nonoperating income (losses):		
Investment income	**114,963**	128,084
Gain on interest rate swaps, net	**16,829**	50,316
Loss on extinguishment of debt	–	(1,598)
Minority interest	–	(12)
Total nonoperating income	**131,792**	176,790
Net income	**181,312**	206,753

Continued on next page.

Clarian Health Partners, Inc. and subsidiaries
Consolidated Statements of Operations and Changes in Net Assets (continued)

(Thousands of Dollars)

	Year Ended December 31	
	2007	**2006**
Unrestricted net assets:		
Net income	**$ 181,312**	$ 206,753
Pension-related changes other than net periodic pension cost	**8,730**	–
Change in minimum pension obligations	–	5,715
Additional pension obligations as a result of adoption of new pension accounting standard	–	(2,123)
Change in fair value of interest rate swaps	–	11,632
Contributions for capital expenditures	**14,305**	–
Other	**(787)**	(3,155)
	203,560	218,822
Temporarily restricted net assets:		
Gifts, bequests, grants, and other	**335**	2,120
Permanently restricted net assets:		
Gifts, bequests, grants, and other	**5,943**	4,262
Increase in net assets	**209,838**	225,204
Net assets at beginning of year	**1,826,925**	1,601,721
Net assets at end of year	**$ 2,036,763**	$ 1,826,925

See accompanying notes.

Clarian Health Partners, Inc. and subsidiaries

Consolidated Statement of Cash Flows

(Thousands of Dollars)

	Year Ended December 31 2007	2006
Operating activities		
Increase in net assets	$ **209,838**	$ 225,204
Adjustments to reconcile increase in net assets to net cash provided by (used in) operating activities:		
Change in interest rate swaps	**5,524**	(61,948)
Pension-related changes other than net periodic pension cost	**(8,730)**	(1,234)
Change due to adoption of new pension accounting standard	**–**	2,123
Income in unconsolidated subsidiaries	**(17,904)**	(16,851)
Depreciation	**164,851**	152,953
Loss on extinguishment of debt	**–**	1,598
Restricted contributions	**(6,278)**	(6,382)
Net changes in operating assets and liabilities:		
Patient accounts receivable, net	**(32,795)**	(47,164)
Inventories and other assets	**(8,400)**	(6,760)
Trading securities	**(24,775)**	(273,595)
Accounts payable and accrued liabilities	**32,538**	(29,971)
Salaries, wages, and related liabilities	**10,472**	2,827
Estimated third-party payor allowances	**8,441**	(9,533)
Net cash provided by (used in) operating activities	**332,782**	(68,733)
Investing activities		
Purchase of property and equipment, net of disposals	**(350,524)**	(290,698)
Net cash used in investing activities	**(350,524)**	(290,698)
Financing activities		
Increase in restricted net assets	**6,278**	6,382
Repayments on long-term debt	**(29,248)**	(408,036)
Proceeds from issuance of long-term debt	**25,000**	712,782
Net cash provided by financing activities	**2,030**	311,128
Decrease in cash and cash equivalents	**(15,712)**	(48,303)
Cash and cash equivalents at beginning of year	**70,165**	118,468
Cash and cash equivalents at end of year	$ **54,453**	$ 70,165

See accompanying notes.

Mission Statement

The mission of Clarian Health is to improve the health of our patients and community through innovation and excellence in care, education, research and service.

Clarian Health will preserve, strengthen and build upon these values:

A patient's ***total care****, including mind, body and spirit*
Excellence in ***education*** *for health care providers*
Quality of care and ***respect*** *for life*
Charity*, equality and justice in health care*
Leadership in health promotion and ***wellness***
Excellence in ***research***
An internal community of ***trust*** *and respect*

1. Organization and Nature of Operations

Organization

Clarian Health Partners, Inc. (Clarian Health), an Indiana nonprofit corporation, and subsidiaries operate as a health care delivery system providing health care services throughout the state of Indiana. Services provided by Clarian Health and its subsidiaries include: acute, nonacute, tertiary, and quaternary care services on an inpatient, outpatient, and emergency basis; medical education and research; medical management services; health care diagnostic and treatment services for individuals and families in physician clinics and physician-group practices; occupational health care for businesses; and personal and home health care.

1. Organization and Nature of Operations (continued)

Clarian Health was formed as an Indiana nonprofit corporation through a consolidation, as of January 1, 1997, under the terms of a Definitive Health Care Resources Consolidation Agreement, as amended (the Consolidation Agreement), and certain other related agreements by and between the Trustees of Indiana University and Methodist Health Group, Inc. The facilities and operations of Indiana University Hospital and Outpatient Center (I.U. Hospital), James Whitcomb Riley Hospital for Children (Riley Hospital), and Methodist Hospital of Indiana (Methodist Hospital) (collectively, the Downtown Hospital Facilities) were merged and consolidated to form Clarian Health, which was licensed as a single, acute care hospital.

Under terms of the Consolidation Agreement and related agreements, substantially all real property of I.U. Hospital, Riley Hospital, and Methodist Hospital was sold, transferred, leased, or otherwise conveyed on a long-term basis (99 years) to Clarian Health at an annual, nominal amount. Substantially all liabilities were also assumed or, in the case of long-term debt, refinanced by Clarian Health. Members of the Board of Directors of Clarian Health are selected by its two classes of members – the Methodist Class (members of which are members of Methodist Health Group, Inc.) and the University Class (members of which are the individuals who are the Trustees of Indiana University).

Nature of Operations

The principal operating activities of Clarian Health and its subsidiaries are conducted at owned facilities or majority-owned or controlled subsidiaries and consist of the following:

Downtown Hospital Facilities (Hospital Campuses) – Consists of three acute, nonacute, tertiary, and quaternary care, and diagnostic facilities, licensed as a single hospital, which comprise the core hospital and health care delivery system of Clarian Health, whose operations are located in the downtown area of Indianapolis, Indiana. Medical education and research, a significant portion of which is provided in conjunction with the Indiana University School of Medicine (School of Medicine) as defined in the Consolidation Agreement, are key elements of Clarian Health's operations.

1. Organization and Nature of Operations (continued)

Suburban Facilities (Clarian West and Clarian North) – Consists of two acute and nonacute care hospitals and medical office buildings located in the western and northern suburban areas of metropolitan Indianapolis, Indiana. Clarian West commenced operations in December 2004, and Clarian North commenced operations in December 2005.

Statewide Facilities – Consists of acute and nonacute care hospitals and health care systems located in Bedford, LaPorte, and Goshen, Indiana. Principal subsidiaries include Bedford Regional Medical Center, Inc. (Bedford), LaPorte Regional Health System, Inc. (LaPorte), and Goshen Health System, Inc. (Goshen).

Ambulatory Care – Consists of occupational health care, personal and home health care, physician offices, and physician-group practices and clinics, substantially all of which are located in Indianapolis, Indiana. Principal subsidiaries or divisions include Methodist Medical Group Physicians, Inc., Emergency Medical Group, Inc., Methodist Cardiology Physicians LLC, Indiana Radiology Partners, Inc., Methodist Occupational Health Centers, Inc., and Clarian Home Care.

Medical Risk – Consists of the medical management of health care services of members whose health care coverage is provided by the managed care networks of Clarian Health.

1. Organization and Nature of Operations (continued)

Clarian Health and its subsidiaries have also entered into certain partnership agreements with physicians for the operation of ambulatory surgery and diagnostic centers (located in Indianapolis, Indiana and the surrounding suburban areas), network or management arrangements with several other hospitals to provide or operate hospital, rural outreach, or other medical services and programs (located in Terre Haute, Tipton, Martinsville, South Bend, Evansville, and Kokomo, Indiana), a joint venture arrangement with another Indianapolis, Indiana, hospital for the operation of a long-term rehabilitative care hospital (also located in Indianapolis, Indiana), a membership and ownership arrangement with five other Indiana hospitals or health systems in a health maintenance organization that offers health insurance plans and claims administration to employers and providers throughout the state of Indiana, a 50% membership interest with a county governmental institution (located in Indianapolis, Indiana) in a nonprofit corporation which holds a health maintenance organization license and manages provider networks serving Medicaid patients, and a 50% membership interest with Indiana University Emerging Technology Corp., a nonprofit corporation, in a specialized cancer treatment and diagnostic clinic (located in Bloomington, Indiana).

2. Community Benefit and Charity Care

Clarian Health and its subsidiaries provide health care services and other financial support through various programs that are designed, among other matters, to enhance the health of the community, improve the health of low-income patients, and foster medical education and research through its affiliation with the School of Medicine. In addition, Clarian Health and its subsidiaries provide services intended to benefit the poor and underserved, including those persons who cannot afford health insurance because of inadequate resources or are uninsured or underinsured. Health care services to patients under government programs, such as Medicare and Medicaid, are also considered part of Clarian Health's benefit provided to the community since a substantial portion of such services are reimbursed at amounts less than cost.

Clarian Health's charity care and financial assistance policy is designed to provide care to patients regardless of their ability to pay. Patients who meet certain criteria for charity care (generally based on up to 400% of federal poverty income guidelines), or who meet criteria to be part of Clarian Health's medical education and research programs, are provided care without charge or at amounts less than established rates. Subsidiaries of Clarian Health have adopted policies which are consistent with the charity care and financial assistance policy of Clarian Health.

2. Community Benefit and Charity Care (continued)

The amount of charity care provided is determined based on the qualifying criteria, as defined in the charity care and financial assistance policy, and applications completed by patients and their families or beneficiaries. No payment for services is anticipated and no billing is prepared for those patients whose charity care applications have been approved. Charity care, measured by the difference between standard charges for services rendered and the amount, if any, ultimately received, was $110,125 and $98,276 in 2007 and 2006, respectively. In addition, Clarian Health and its subsidiaries provide a significant amount of uncompensated care to uninsured and underinsured patients, which is included in the provision for uncollected patient accounts and includes amounts for patients who may have otherwise qualified for charity care but did not complete applications.

Reimbursements are received by Clarian Health and its subsidiaries for Medicare and Medicaid beneficiaries in accordance with reimbursement agreements and related regulatory rules and regulations. Also, as a Medicaid Disproportionate Share (DSH) provider (see Note 3), Clarian Health receives certain DSH payments for those patients who qualify as medically indigent. These reimbursements and payments are less than the cost of providing the related services.

Clarian Health also provides education for health care providers, including support to the School of Medicine; counseling centers and chaplaincy programs which support patients' medical, spiritual, and emotional needs; programs to enhance quality of and respect for life, including neighborhood revitalization, community health clinics and school clinics; charity, equality, and justice programs, including AIDS clinic, older adult clinics, and other clinical programs; health promotion and wellness programs, including OASIS (an over 55-age program), Indiana Poison Center, safe driving, pregnancy and parenting classes, and other prevention and intervention programs; other medical research and support to the Medical Knowledge Fund, Children's Values Fund; and internal community of trust, respect, and empowerment, including employee wellness development. The costs of providing these programs and services are included in expenses in the accompanying consolidated statements of operations and changes in net assets.

3. Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Clarian Health and all majority-owned or controlled subsidiaries. The equity method of accounting is used for investments in joint ventures, partnerships, and companies where control is participatory with others or where ownership is 50% or less. All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements, in conformity with U.S. generally accepted accounting principles, requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Fair Values of Financial Instruments

Financial instruments include cash and cash equivalents, patient, member premium, and other accounts receivable, assets limited as to use, accounts payable and accrued expenses, estimated third-party payor allowances, long-term debt, derivative financial instruments (i.e., interest rate, basis, and short duration swaps), and certain other current assets and liabilities. The fair values for cash and cash equivalents, patient, member premiums, and other accounts receivable, accounts payable and accrued expenses, accrued health claims, estimated third-party payor allowances, and certain other current assets and liabilities approximate the carrying amounts reported in the consolidated balance sheets and, in the opinion of management, represent highly liquid assets or short-term obligations not subject to being discounted. The fair values for assets limited as to use, derivative financial instruments, and long-term debt are described in Notes 4, and 6.

Derivative Financial Instruments

As part of its Asset/Liability Management Program, Clarian Health has entered into interest rate swap, basis swap, and short duration swap transactions. Clarian Health accounts for its derivative instruments under Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for*

3. Summary of Significant Accounting Policies (continued)

Derivative Instruments and Hedging Activities, as amended, and Statement of Position (SOP) 02-2, *Accounting for Derivative Instruments and Hedging Activities by Not-for-profit Healthcare Organizations.* SOP 02-2 requires that not-for-profit health care organizations apply the provisions of SFAS No. 133 (including the provision pertaining to cash flow hedge accounting) in the same manner as for-profit enterprises, and clarifies that the performance indicator reported by not-for-profit health care organizations is analogous to income from continuing operations for a for-profit enterprise. SFAS No. 133 requires that derivative instruments be recognized as either assets or liabilities in the consolidated balance sheets at fair value. The accounting for changes in fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and on the type of hedging relationship.

For those derivative instruments that are designated and qualify as hedging instruments, a determination must be made as to whether such instruments are a fair value hedge, cash flow hedge, or hedge of a net investment in a foreign operation. To the extent that such derivative financial instruments are designated and qualify as cash flow hedging instruments, the effective portion of the gain or loss on the derivative instrument is reported as a component of net assets and reclassified to net income in the same period or periods during which the hedged transaction affects earnings. As of and for the years ended December 31, 2007 and 2006, Clarian Health's basis swap and short duration swap agreements did not qualify for hedge accounting. However, the interest rate swap agreements entered into in connection with the Series 2005A, B, C, and D and Series 2003A, B, C, D, E, F, and G bonds were designated and qualified as cash flow hedges during 2006, the effect of which was to fix the long-term interest rate at rates ranging from 2.57% to 4.92%. On January 1, 2007, management of Clarian Health elected to dedesignate those derivative instruments previously qualifying for hedge accounting. All changes in the fair value of these derivative instruments in 2007 were reflected as a component of nonoperating income in the accompanying consolidated statements of operations and changes in net assets. Approximately $18,885 was accumulated as a component of net assets as of December 31, 2006 and is being amortized into income as the previously hedged debt affects earnings. During the year ended December 31, 2007, $1,296 was reclassified into income based upon this allocation method.

3. Summary of Significant Accounting Policies (continued)

Net Patient Service Revenue

Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered. Certain revenue is subject to estimated retroactive revenue adjustments under reimbursement agreements with third-party payors due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period that the related services are rendered, and such amounts are adjusted in future periods as adjustments become known.

For the year ended December 31, 2007, the percentage of net patient service revenue derived under Medicare, Medicaid, and managed care programs approximated 19%, 8%, and 51%, respectively (21%, 8%, and 51%, respectively, in 2006). One managed care provider, Wellpoint, Inc., represented 21% of net patient service revenue in 2007 and 22% in 2006. Provision has been made, by a charge to contractual allowances as an offset to patient service revenue, for the differences between gross charges for patient services and estimated reimbursement from these government and insurance programs.

Clarian Health qualifies as a Medicaid DSH provider under Indiana law (HEA 1095, Public Law 27-1992) and, as such, is eligible to receive DSH payments. The amount of these additional DSH funds is dependent on regulatory approval by agencies of the federal and state governments, and is determined by the level, extent, and cost of uncompensated care (as defined) and various other factors. For the years ended December 31, 2007 and 2006, DSH payments have been made by the state of Indiana, and Clarian Health recorded such amounts as revenue based on preliminary data acceptable to the state of Indiana less any amounts management believes may be subject to adjustment. DSH payments by the state of Indiana are based on the fiscal year of the state, which ends June 30th of each year.

Laws and regulations governing Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is a reasonable possibility that recorded estimated settlements could change by a material amount in the near term. Clarian Health received favorable Medicare and Medicaid settlements and resolutions on prior year filed and appealed cost reports and other matters, which increased net income by $3,095 in 2007 and $25,128 in

3. Summary of Significant Accounting Polices (continued)

2006. The state of Indiana finalized Clarian Health's reimbursement under the state DSH program for the state fiscal years 2004 and 2005, resulting in additional net income to Clarian Health for 2007 of $12,472 and for 2006 of $19,976. Additional net income recorded in 2007 and 2006 related to other changes to expected reimbursement under the state DSH program was $19,453 and $14,263, respectively.

Member Premium Revenue and Health Claims

Clarian Health and its subsidiaries have agreements to provide medical services to subscribing participants or members. These agreements generally provide for pre-defined payments (on a per member/per month basis) regardless of services actually performed.

The cost to provide health care services under these agreements is accrued in the period in which the health care services are provided to a member based, in part, on estimates, including an accrual for medical services provided but not yet reported. A portion of these expenses are intercompany between Clarian Health and its subsidiaries, which are eliminated in consolidation. Expenses which are not related to Clarian Health are reported as health claims to providers in the accompanying consolidated statements of operations and changes in net assets.

Cash Equivalents

Investments in highly liquid instruments with an original maturity of three months or less when purchased, excluding assets limited as to use, are considered by management to be cash equivalents. Clarian Health and its subsidiaries routinely invest in money market funds. These funds generally invest in highly liquid U.S. government and agency obligations.

Accounts Receivable and Allowance for Doubtful Accounts

Clarian Health and its subsidiaries extend credit to patients, substantially all of whom are residents of the state of Indiana, and do not require collateral or other security for the delivery of health care services. However, assignment of benefit payments payable under patients' health insurance programs and plans (e.g., Medicare, Medicaid, health maintenance organizations, and commercial insurance policies) is routinely obtained, consistent with industry practice.

(Thousands of Dollars)

3. Summary of Significant Accounting Policies (continued)

The provision for uncollected patient accounts is based upon management's assessment of historical and expected net collections considering business and economic conditions, changes and trends in health care coverage, and other collection indicators. Periodically, management assesses the adequacy of the allowance for uncollectible accounts based upon accounts receivable payor composition and aging, and historical write-off experience by payor category, as adjusted for collection indicators. The results of this review are then used to make any modifications to the provision for uncollected patient accounts and the allowance for uncollectible accounts. In addition, Clarian Health and its subsidiaries follow established guidelines for placing certain past due patient balances with collection agencies. Patient accounts which are uncollected, including those placed with collection agencies, are initially charged against the allowance for uncollectible accounts in accordance with collection policies of Clarian Health and, in certain cases, are reclassified to charity care if deemed to otherwise meet Clarian Health's charity care and financial assistance policy. The composition of net patient accounts receivable is summarized as follows as of December 31:

	2007	**2006**
Managed care	**50%**	45%
Medicare	**12**	17
Medicaid	**7**	10
Other third-party payors	**11**	12
Patients	**20**	16
	100%	100%

One managed care provider, Wellpoint, Inc., represented 20% and 19% of gross patient accounts receivables in 2007 and 2006, respectively.

Inventories

Inventories consist primarily of drugs and supplies, are stated at the lower of cost or market, and are generally valued using the average cost method.

Assets Limited as to Use

Assets limited as to use include: (i) cash and cash equivalents and designated investment assets set aside by the Board of Directors (the Board) for future capital improvements and for other

3. Summary of Significant Accounting Policies (continued)

purposes, over which the Board retains control and may, at its discretion, use for other purposes and (ii) assets held by trustees under bond or trust indenture agreements for construction and debt service. Substantially all assets limited as to use are invested and managed by professional investment managers and are held in custody by financial institutions. All such funds are classified as trading securities. Accordingly, changes in unrealized gains and losses in the fair value of investments are included in nonoperating income with investment income in the accompanying consolidated statements of operations and changes in net assets.

Property and Equipment

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets. Included in property and equipment are costs for software developed for internal use accounted for in accordance with SOP 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use.*

Equipment under capital lease obligations is amortized on the straight-line method over the lease term or the estimated useful life of the equipment, whichever period is shorter. Such amortization is included with depreciation in the accompanying consolidated statements of operations and changes in net assets. Interest cost incurred on borrowed funds during the period of construction, and other interest costs related to tax-exempt bonds are capitalized as a component of the cost of constructing the assets. In addition, interest earnings on unexpended borrowed funds related to tax-exempt financings are offset to capitalized interest. Repair and maintenance costs are expensed when incurred.

Clarian Health and its subsidiaries evaluate when events or changes in circumstances have occurred which would indicate that the remaining estimated useful life of long-lived assets warrant revision or that the remaining balance of such assets may not be recoverable. The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset or asset group. Such events or changes in circumstances may include any of the following: a significant decrease in the market price of a long-lived asset; a significant adverse change in the extent or manner in which a long-lived asset is being used or its physical condition; a significant adverse change in legal factors or business climate that could affect the value of a long-lived asset; an accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of a long-lived asset; a protracted loss of cash flows which would indicate continued losses associated with the use of a long-lived asset; and a current expectation that a long lived-asset will be sold or otherwise disposed of significantly before the end of its previously estimated

3. Summary of Significant Accounting Policies (continued)

useful life. Such estimates of loss are identified and calculated in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.*

Environmental Obligations

Clarian Health follows the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations – an interpretation of SFAS No. 143* (FIN 47). SFAS No. 143 provides guidance on accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. Asset retirement obligations include, but are not limited to, certain types of environmental issues that are legally required to be remediated upon an asset's retirement as well as contractually required asset retirement obligations. Conditional asset retirement obligations are obligations whose settlement may be conditional on a future event and/or where the timing or method of such settlement may be uncertain. FIN 47 guidance requires such conditional asset retirement obligations to be estimated and recognized. Application of these pronouncements primarily affects Clarian Health's Downtown Hospital Facilities with respect to required future asbestos remediation. As of December 31 2007 and 2006, remediation costs aggregating $4,351 and $4,303, respectively, were carried for future abatement of asbestos and are included in other noncurrent liabilities on the accompanying consolidated balance sheets.

Unamortized Bond Issuance Costs and Bond Discount or Premium

Costs incurred in connection with the issuance of long-term debt and bond discounts or premiums are amortized or accreted using the effective interest rate method. Amortization and accretion is included in interest expense in the accompanying consolidated statements of operations and changes in net assets.

Medical Malpractice

Clarian Health's medical malpractice coverage is provided through a program of commercial insurance with a self-insured retention for claims made prior to July 1, 2002, and coverage through captive insurance companies effective July 1, 2002. The program of medical malpractice coverage considers limitations in claims and damages prescribed by the Indiana Medical Malpractice Act (the Act), which limits the amount of individual claims up to $1,250 and annual aggregate claims up to $7,500, of which up to $1,000 would be paid by the state of Indiana

3. Summary of Significant Accounting Policies (continued)

Patient Compensation Fund (the Fund) and $250 by Clarian Health for each individual claim. The Act also requires that health care providers meet certain requirements, including making funding payments to the Fund, and maintaining certain insurance levels. Clarian Health has met these requirements and is a qualified provider under the Act, retaining risk of $250 per occurrence and up to $7,500 in the annual aggregate.

Subsidiaries and affiliates of Clarian Health also participate in the medical malpractice program, including coverage offered by the captive insurance companies (or, from July 1, 2002 to June 30, 2004, by the fronting carrier, Continental Casualty Company). Commercial insurance carriers also provide reinsurance for certain excess general liability coverage of the captive insurance companies on a claims-made basis (aggregating $80,000). To the extent that insurance coverage for medical malpractice is not provided by commercial insurance carriers, including reinsurers, contributions to the program are determined using on a claims-made basis.

Contributions to the captive program are expensed as incurred and loss reserves are established for incurred but not yet reported claims. Laws in the jurisdiction in which the captive insurance companies are domiciled require, among other matters, that certain capital and funding requirements be met. Clarian Health has recorded an actuarially determined amount of approximately $50,083 and $41,899 at December 31, 2007 and 2006, respectively, for malpractice claims. For the years ended December 31, 2007 and 2006, Clarian Health expensed $16,986 and $12,667, respectively.

Investments held by the captive insurance companies aggregated $55,922 and $43,833 at December 31, 2007 and 2006, respectively, and are included in the accompanying consolidated balance sheets with Board-designated investment funds. In addition, included with other assets in the consolidated balance sheets are Board-designated investment funds held in trust of $1,140 and $686 at December 31, 2007 and 2006, respectively, which are designated for malpractice and certain other claims.

Temporarily and Permanently Restricted Net Assets

Interests in net assets of foundations are accounted for in accordance with SFAS No. 136, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others*, the underlying assets of which consist primarily of cash and cash equivalents, money market and mutual funds, and marketable equity and debt securities.

3. Summary of Significant Accounting Policies (continued)

Temporarily and permanently restricted net assets are those assets whose use has been limited by donors to a specific time period or purpose. These net assets are generally restricted for indigent and other patient care services, medical education and research programs, and medical supplies and equipment.

Operating and Performance Indicators

The activities of Clarian Health and its subsidiaries are primarily related to providing health care services and, accordingly, expense information by functional classification is not used as a basis for measuring performance. Further, since substantially all resources are derived from providing health care services, similar to that if provided by a business enterprise, the following indicators are considered important in evaluating how well management has discharged their stewardship responsibilities:

> **Operating Indicator (Operating Income)** – Includes all unrestricted revenue, gains, and other support, equity income of unconsolidated health care subsidiaries, and expenses directly related to the recurring and on-going health care operations during the reporting period. The operating indicator excludes investment income on assets limited as to use (including changes in unrealized gains and losses on investments), changes in the fair value of interest rate, basis, and short duration swaps, loss on the extinguishment of debt, minority interest, and gains and losses deemed by management not to be directly related to providing health care services.
>
> **Performance Indicator (Net Income)** – Includes operating income and nonoperating income. The performance indicator excludes certain changes in the pension obligations, the adoption of new accounting standards related to pension (2006), changes in the fair market value of swap arrangements deemed to qualify for hedge accounting prior to January 1, 2007 dedesignation (presently interest rate swaps), and contributions for capital expenditures.

3. Summary of Significant Accounting Policies (continued)

Income Taxes

The Internal Revenue Service has determined that Clarian Health and certain of its affiliated entities are tax-exempt organizations as defined in Section 501(c)(3) of the Internal Revenue Code. The Suburban Hospitals are organized as pass-through limited liability companies for which Clarian Health's share of operating results is generally not taxable. Certain subsidiaries of Clarian Health are taxable entities, the tax expense and liabilities of which are not material to the consolidated financial statements.

In June 2006, FASB Interpretation No. 48 (FIN 48) *Accounting for Uncertainty in Income Taxes,* an interpretation of SFAS No. 109, *Accounting for Income Taxes*, was issued. This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest, and penalties, accounting for interim periods, disclosure, and transition. This standard became effective for Clarian Health during the year ended December 31, 2007. Compliance with this standard had no material impact on the consolidated financial statements of Clarian Health.

Recent Accounting Standards Not Required for 2007

In September 2006, SFAS No. 157, *Fair Value Measurements* was issued. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with U.S. generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, with earlier application encouraged. Any amounts recognized upon adoption as a cumulative effect adjustment will be recorded to the opening balance of unrestricted net assets in the year of adoption.

Clarian Health adopted SFAS No. 157 on January 1, 2008. The adoption did not have a material impact on Clarian Health's consolidated financial position or consolidated results of operations.

4. Assets Limited as to Use

Board-designated investment funds are invested in accordance with Board-approved policies, which include, among other matters, targeted investment returns balanced by diversification of the investment portfolio, establishment of credit risk parameters, and limitation in the amount of investment in any single organization. Trustee-held funds are generally invested in cash equivalents and U.S. government and agency obligations, as defined by the debt agreements. Clarian Health has determined the estimated fair value of the assets limited as to use using market information and other appropriate valuation methodologies.

Clarian Health also has investments with limited liability partnerships (LLPs) that focus on absolute return investment strategies. These LLPs utilize a multi-manager, fund of funds approach designed to produce positive investment returns regardless of market direction. The underlying investments may include equity, fixed income securities, commodities, currencies, and derivatives. These instruments are subject to various risks similar to nonderivative financial instruments including market, credit, liquidity, operational, and foreign exchange risk. The largest allocation to any fund of funds manager is $143,218 at December 31, 2007. Clarian's investment in any individual LLP is less than 7% of that fund's net assets. Generally, redemption may be made with written notice ranging from sixty to ninety days. These investments are accounted for under the equity method of accounting, based on the LLPs' financial information, which is generally one month in arrears when Clarian Health prepares its financial statements. Changes in fair value of these LLPs are included in nonoperating income with investment income in the accompanying consolidated statements of operations and changes in net assets.

The methods and assumptions used by Clarian Health and its subsidiaries to estimate the fair value of assets limited as to use are: cash and cash equivalents – the carrying amounts reported in the consolidated balance sheets approximate fair value; marketable securities – the fair value

(Thousands of Dollars)

4. Assets Limited as to Use (continued)

amounts of marketable securities are based on quoted market prices or, if quoted market prices are not available, fair values are based on quoted market prices of comparable instruments; and other investments, including the fund of funds investments – these investments are accounted for under the equity method or stated at fair value as determined by the administrators of each underlying fund, in consultation with fund investment managers.

The composition of assets limited as to use is set forth below.

	December 31	
	2007	**2006**
Cash and cash equivalents	$ **185,214**	$ 213,149
Marketable securities:		
U.S. government and agency obligations	**117,341**	93,370
U.S. corporate obligations	**56,073**	46,191
U.S. equity securities	**624,565**	580,444
Non-U.S. securities	**134,564**	196,435
Total marketable securities	**932,543**	916,440
Other investments:		
Absolute return strategy (fund of funds):		
Tiff ARP	**31,746**	28,389
Arden Endowment Advisors, Ltd.	**–**	124,333
BlackRock Alternative Advisors (formerly Quellos Strategic Partners 2006)	**143,218**	126,158
Aurora Offshore Fund, Ltd.	**113,325**	–
Magnitude International	**27,681**	–
Real estate investment trusts and other	**10,878**	11,361
Total other investments	**326,848**	290,241
	1,444,605	1,419,830
Less current portion	**(7,060)**	(5,950)
Total assets limited as to use, less current portion	$ **1,437,545**	$ 1,413,880

(Thousands of Dollars)

4. Assets Limited as to Use (continued)

The current portion of assets limited as to use represents construction draws on trustee-held funds for amounts included in accounts payable.

In December 2006, Clarian Health redeemed a portion of securities held in Arden Endowment Advisors, Ltd. All redeemed funds were deposited into a money market account at redemption, and the redemption proceeds were reinvested in other absolute return strategy funds in 2007.

In December 2007, Clarian Health redeemed a portion of securities held in Tiff ARP. All redeemed funds were deposited into a money market account at redemption, and the redemption proceeds are to be reinvested in other absolute return strategy funds in 2008.

The aggregate cost of investments was $1,147,337 and $1,249,402 at December 31, 2007 and 2006, respectively. The composition and presentation of investment income recognized in the accompanying consolidated statements of operations and changes in net assets are as follows:

	December 31	
	2007	**2006**
Other operating revenue:		
Interest income on escrowed funds prior to debt Retirement	**$ –**	$ 4,879
Nonoperating income:		
Interest income on borrowed funds not capitalized	**989**	791
Interest and dividend income	**24,122**	25,985
Realized gains and losses on sales of investments, net	**60,914**	31,066
Changes in unrealized gains (losses) on investments	**(7,979)**	47,665
Equity gains and losses of Absolute Return Strategy investments	**36,917**	22,577
	$ 114,963	$ 132,963

(Thousands of Dollars)

5. Property and Equipment

The cost of property and equipment in service is summarized as follows:

	December 31	
	2007	**2006**
Land and improvements	**$ 182,198**	$ 167,836
Buildings and improvements	**1,435,636**	1,386,754
Equipment (including software developed for internal use of $150,234 in 2007 and $142,399 in 2006)	**1,331,369**	1,224,353
	$ 2,949,203	$ 2,778,943

Useful lives of each category of assets are based on the estimated useful time frame that the particular assets are expected to be in service, generally in accordance with guidelines established by the American Hospital Association. Assets are depreciated on a straight-line basis with asset lives ranging as follows: land improvements (20–30 years), buildings and improvements (15 – 40 years), and equipment, including software developed for internal use (3 – 10 years).

Construction-in-progress is anticipated to extend through 2011 and includes commitments for the construction, refurbishment, and replacement of facilities and equipment. A summary of the construction-in-progress is as follows:

	December 31	
	2007	**2006**
Software developed for internal use	**$ 18,727**	$ 1,282
Education and resource center	**26,825**	4,808
Riley bed tower	**100,376**	38,867
Cancer hospital	**107,903**	57,877
Clarian Arnett hospital	**104,629**	16,729
Other facilities and equipment	**34,458**	104,497
	$ 392,918	$ 224,060

Firm commitments for construction-in-progress totaled $255,251 at December 31, 2007. However, other amounts are anticipated to be incurred but are not legally required or committed and are subject to change or authorization by the Board, aggregating approximately $440,000.

(Thousands of Dollars)

5. Property and Equipment (continued)

Certain medical and computer equipment and software are accounted for as capital leases expiring in various years through 2012 and are included in property and equipment. Amortization of assets under capital leases is included in depreciation expense. The following is a summary of property held under capital leases:

	December 31 2007	December 31 2006
Medical software	$ **20,885**	$ 20,885
Computer equipment	**1,139**	-
Medical equipment	**8,060**	4,311
	30,084	25,196
Less accumulated amortization	**(13,938)**	(7,222)
	$ **16,146**	$ 17,974

Interest rates on capital leases vary from 2.9% to 9.3% and are imputed based on the lower of the incremental borrowing rate at the inception of each lease or the lessor's implicit rate of return.

6. Long-Term Debt

Obligated Group

A Master Trust Indenture (MTI), as amended, provides for the issuance of long-term debt under an obligated group structure. The Obligated Group includes Clarian Health and LaPorte as Members. This group is required to meet covenants under the MTI, and the Members are jointly and severally liable for the obligations under the MTI. The Obligated Group is also subject to financial performance covenants that, among other compliance requirements, require the maintenance of debt service ratios and limit the Obligated Group's ability to encumber certain of its respective assets. Certain affiliates of Clarian Health have been designated by Clarian Health, pursuant to the terms of the MTI, as Obligated Group Affiliates. While Obligated Group Affiliates are not directly liable for payment of obligations, the MTI requires that each Obligated Group Affiliate be controlled by a member of the Obligated Group. This control helps ensure compliance with the covenants of the MTI. Each Obligated Group Affiliate is required to pay, loan, or otherwise transfer to members of the Obligated Group such amounts as necessary to pay outstanding obligations that were made available to the Obligated Group Affiliate, and any other

6. Long-Term Debt (continued)

amounts necessary for the Obligated Group Members to pay such obligations. As of December 31, 2007, management of the Obligated Group and Obligated Group Affiliates believe that they are in compliance with all financial covenants.

Due to changing market conditions, the interest rates for certain variable rate notes relating to Clarian Health's Auction Rate Securities have reset at a higher rate. This reset has caused the effective rate of these obligations to increase compared to those rates existing, and disclosed, at December 31, 2007. The terms and conditions of the MTI and other related agreements, as well as the classification of the related debt, covenants and other requirements on Clarian Health have not resulted in changes of the Auction Rate Securities other than the reset of the interest rate. The resetting of the interest rate occurs periodically every 7 to 35 days subject to the results of the auction process, and is established based on the then-outstanding market conditions, which can increase or decrease the interest rate, but cannot exceed an interest rate of 15%.

Issuance and Extinguishment of Debt

On December 7, 2007, Clarian Health entered into an unsecured Loan Agreement for $25,000 with Stonehenge Community Development VII, LLC. The proceeds will be used to partially finance the cost of construction of the education and resource center.

On January 24, 2006, Clarian Health issued, through the Indiana Finance Authority, formerly the Indiana Health and Educational Facility Financing Authority (IHEFFA), Tax-Exempt Fixed-Rate Hospital Revenue Bonds, Series 2006A in the amount of $327,170 under the MTI. The proceeds are being used to finance the cost of construction, renovation, and equipping of health facilities and to pay related costs of issuance

On September 14, 2006, Clarian Health issued, through the IHEFFA, Tax-Exempt Fixed-Rate Hospital Refunding Revenue Bonds Series 2006B in the amount of $375,485 under the MTI. The proceeds, including original issue premium, net of issuance costs, were used to purchase a guaranteed investment contract in order to refund the outstanding Indiana Health Facility Financing Authority (predecessor to IHEFFA) Variable Rate Demand Tax-Exempt Hospital Revenue Bonds, Series 1996B and Series 1996C ($109,300), Variable Rate Demand Tax-Exempt Hospital Revenue Bonds, Series 2000B and Series 2000C ($182,000), and Variable Rate

(Thousands of Dollars)

6. Long-Term Debt (continued)

Demand Tax-Exempt Hospital Revenue Bonds, Series 2003H and Series 2003I ($95,000) on the redemption date of December 12, 2006. This transaction also eliminated the liquidity support needed for the refunded bonds that was provided by two commercial banks, JP Morgan/Chase Bank (as successor to Bank One N.A.) and Bank of Nova Scotia, pursuant to Standby Bond Purchase Agreements. This 2006 transaction resulted in investment income on the guaranteed investment contract (included in other operating revenue) of $4,879 and interest expense of $2,945, and a loss on extinguishment of debt of $1,598, including the write-off of related costs, reported in nonoperating income.

Long-term debt as of December 31, 2007 and 2006 consists of the following

	2007	2006
Indiana Health and Educational Facility Financing Authority:		
Fixed Rate, Tax-Exempt Hospital Revenue Bonds, Series 2006A Serial Term Bonds, payable in varying principal installments through 2040, with interest rates ranging from 4.75% to 5.25%	**$ 327,170**	$ 327,170
Fixed Rate, Tax-Exempt Hospital Refunding Revenue Bonds, Series 2006B Serial and Term Bonds, payable in varying principal installments from 2007 through 2040, with interest rates ranging from 4.75% and 5.00%	**369,960**	375,485
Auction Rate Securities, Tax-Exempt Revenue Bonds, Series 2005A, B, C and D, - Serial Bonds, payable in varying principal installments from 2007 through 2030, variable interest rates of 4.15%, 4.25%, 4.55%, 5.00%, respectively, at December 31, 2007 (3.90%, 3.85%, 3.80%, 3.80%, respectively, at December 31, 2006)	**322,625**	325,525
Auction Rate Securities, Tax-Exempt Revenue Bonds, Series 2003A, B, C and D – Serial Bonds, payable in varying principal installments from 2007 through 2033, variable interest rates of 4.00%, 4.75%, 4.40%, and 5.00%, respectively, at December 31, 2007 (3.60%, 3.55%, 3.80%, and 3.75%, respectively, at December 31, 2006)	**175,325**	180,000
Auction Rate Securities, Taxable Hospital Revenue Bonds, Series 2003E, F and G – Serial Bonds, payable in varying principal installments from 2007 through 2033, variable interest rates of 5.60%, 5.60%, and 5.60%, respectively, at December 31, 2007 (5.30%, 5.27%, and 5.34%, respectively, at December 31, 2006)	**221,975**	225,000
Fixed Rate Tax-Exempt Hospital Revenue Bonds, Series 2000A Serial Bonds, payable in varying principal installments through 2010 with interest rates ranging from 4.75% to 5.20%	**3,755**	4,910
Fixed Rate Tax-Exempt Hospital Revenue Bonds, Series 1996A Serial and Term Bonds, payable in varying principal installments through 2007 with interest rates ranging from 5.25% to 6.0%	**–**	7,815
Stonehenge Community Development VII, LLC		
Fixed Rate, Unsecured New Market Tax Credit Notes A and B, paying interest only through 2014 at an interest rate of 3.292%	**25,000**	–
Capital lease obligations and other (interest rates ranging from 2.9% to 9.3%)	**20,205**	24,109
	1,466,015	1,470,014
Unamortized premium	**4,864**	5,090
Less current portion	**(29,541)**	(29,466)
Long-term portion, less current portion	**$ 1,441,338**	$1,445,638

(Thousands of Dollars)

6. Long-Term Debt (continued)

The scheduled maturities and mandatory redemptions of long-term debt are as follows:

Year ending December 31:	
2008	$ 29,541
2009	29,447
2010	31,453
2011	32,167
2012	30,242
Thereafter	1,313,165
	$ 1,466,015

The estimated fair value of long-term debt at December 31, 2007 and 2006 amounted to $1,453,320 and $1,472,239, respectively, based on market interest rates and conditions for similar issues as of those dates.

Interest Rate Swap Arrangements

Clarian Health entered into long-term interest rate swap arrangements related to the Series 2006, Series 2005, and Series 2003 Revenue Bonds to mitigate interest rate risk. Specifically, Clarian Health entered into the following fixed payor swaps:

- $175,500 Series 2005A and B receiving 62.3% LIBOR plus .24% and paying 3.19%.
- $152,925 Series 2005C and D receiving 62.3% LIBOR plus .24% and paying 3.35%.
- $180,000 Series 2003A, B, C, and D receiving 67% LIBOR and paying 2.570% to 3.225%.
- $225,000 Series 2003E, F, and G receiving LIBOR and paying 4.924%.

In July 2007, Clarian Health entered into a long-term fixed receiver swap to replace the expiring short-duration swap program. Specifically, Clarian Health entered into the following fixed receiver swap.

$325,000 Series 2006A paying 69.6% LIBOR and receiving 4.23%

6. Long-Term Debt (continued)

During 2006, Clarian Health entered into a long-term interest rate swap to convert the Series 2006B fixed rate bonds into synthetic variable rate bonds. Specifically, Clarian Health entered into the following fixed receiver swap:

- $387,109 Series 2006B paying SIFMA receiving 4.23%.

Clarian Health also previously entered into a short duration (three years) fixed-to-variable interest rate swap program to reduce interest expense, which expired in 2007. Specifically, the following fixed receiver swaps were:

- $180,000 Series 2003A, B, C, and D receiving 2.45%.
- $225,000 Series 2003E, F, and G receiving 3.10%.
- $148,755 Series 2000A receiving 2.53%.
- $182,335 Series 1996A receiving 2.39%.

Clarian Health had also entered into basis swaps to hedge interest rate fluctuations related to certain variable interest rates in the notional amount of $1,326,045. These swaps were terminated at market value for a one–time cash payment of $22,299 in April 2007 and resulted in a gain of $1,707 included in gain on interest rate swaps during 2007.

During 2007, Clarian Health also entered into a $500,000 (notional amount) Constant Maturity Swap paying SIFMA and receiving 88.4% 10-Year SIFMA with a forward starting date of December 2007.

6. Long-Term Debt (continued)

The fair values of the swaps have been included with other assets and noncurrent liabilities in the accompanying consolidated balance sheets.

Total interest paid on long-term debt for the years ended December 31, 2007 and 2006, aggregated $67,829 and $58,172, respectively. Total interest capitalized during the years ended December 31, 2007 and 2006 amounted to $23,490 and $23,322, respectively, which was offset by interest income of $8,868 and $12,327, respectively, on nontaxable, unexpended borrowed funds.

In February 2006, Clarian Health entered into a $50,000 unsecured bank line of credit. The agreement has a variable interest rate based on LIBOR. No amounts were outstanding under this line of credit at December 31, 2007.

Pending Issuance of Debt

Clarian Health has begun a process of evaluating alternatives to replace all, or substantiality all, of its Auction Rate Securities through the conversion of the auction rate mode to other financing modes, within its existing bond documents. Clarian Health is also reviewing the impact of refinancing a portion of the Auction Rate Securities through a refunding, which may involve terminations of certain interest rate swaps. The plan of finance has not been finalized and the resulting adjustment to the composition of Clarian's long-term debt portfolio and interest rate swap program is under review due to changing and volatile market conditions. Management of Clarian Health expects the conversion or refunding to be completed in April 2008 and, in the opinion of management, is not expected to result in any material adverse effect on the financial condition of Clarian Health.

(Thousands of Dollars)

7. Commitments and Contingencies

Leases

In December 1998, Clarian Health entered into a sale-leaseback arrangement with a real estate investment trust. Under the arrangement, various outpatient and professional office facilities were sold and then leased back for a period of ten years. The leaseback has been accounted for as an operating lease. The gain of $24,345 realized on this transaction has been deferred and is being accreted to income on a straight-line basis over the lease term. For the years ended December 31, 2007 and 2006, $2,434 of gain was recognized each year relating to the sale. At December 31, 2007 and 2006, $2,232 and $4,665, respectively, of the financing obligation were included with other noncurrent liabilities. Lease payments under the agreement were $7,125 and $7,115 for the years ended December 31, 2007 and 2006, respectively.

Rent and lease expense amounted to $41,047 and $34,968, respectively, for the years ended December 31, 2007 and 2006.

Other buildings and medical and office equipment are leased under noncancelable operating leases. Future minimum lease payments as of December 31, 2007 are as follows:

Year ending December 31:	Operating Leases	Capital Leases
2008	$ 23,325	$ 5,315
2009	11,131	5,028
2010	3,755	4,404
2011	1,799	4,125
2012	1,341	1,000
Thereafter	5,436	-
Total minimum lease payments	$ 46,787	$ 19,872
Less amount representing interest		(2,595)
Present value of net minimum lease Payments		$ 17,277

8. Retirement Plans

Defined Contribution Plans

Clarian Health's Downtown Hospital Facilities established defined contribution plans at the time of Clarian Health's formation. Effective January 1, 2007, LaPorte adopted a defined contribution plan (which replaced a curtailed defined benefit pension plan) covering substantially all of its employees. Goshen and Bedford each have defined contribution plans. The Suburban Hospitals have profit-sharing plans that their employees are eligible to participate in. Consequently, pension benefits are provided to substantially all employees of Clarian Health and its subsidiaries primarily through defined contribution plans. Contributions to the defined contribution plans are based on compensation of qualified employees and amounted to $47,419 in 2007 and $34,485 in 2006 (net of forfeitures of $2,235 and $4,921 in 2007 and 2006, respectively).

Defined Benefit Plans

Pension benefits provided through noncontributory, defined benefit pension plans are principally limited to current and former employees of Clarian Health who elected not to participate in the defined contribution plan established at the time of Clarian Health's formation, current and former executives of Clarian Health who participated in a supplemental employee retirement plan, and current and former employees of LaPorte who were participants in the defined benefit pension plan as of November 30, 2006. The defined benefit plans have been curtailed, and no new participants are permitted. Pension benefits are based on years of service and compensation of employees (as defined) and are actuarially determined. Where applicable, the funding policy is to annually contribute the contribution required to comply with ERISA regulations.

Effective December 31, 2006, Clarian Health adopted the recognition and disclosure requirements of SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. Adjustments to pension liability to reflect funded status are charged or credited to unrestricted net assets. The effect of adopting SFAS No. 158 increased the accrued pension obligations and decreased unrestricted net assets in the amount of $2,123 at December 31, 2006.

The following table sets forth the funded status of the defined benefit pension plans and amounts recognized in the consolidated financial statements as of and for the years ended December 31, 2007 and 2006. The date of data collection was January 1 for 2007 and 2006 (rolled forward to year-end and adjusted for changes in employment status).

(Thousands of Dollars)

8. Retirement Plans (continued)

		2007		2006
Change in benefit obligation of the plans:				
Benefit obligation at beginning of the year	$	**119,667**	$	131,200
Service cost and other		**1,001**		9,813
Interest cost		**6,688**		6,897
Actuarial (gain)		**(8,237)**		(4,779)
Benefits paid		**(4,173)**		(13,361)
Gain due to pension curtailment		**–**		(10,103)
Benefit obligation at end of year	$	**114,946**	$	119,667
Change in assets of the plans:				
Fair value of assets at beginning of year	$	**88,887**	$	78,171
Actual return on assets		**7,129**		10,142
Employer contributions		**4,435**		13,935
Benefits paid		**(4,173)**		(13,361)
Fair value of assets at end of year	$	**96,278**	$	88,887
Funded status at December 31	$	**(18,668)**	$	(30,780)
Items not yet recognized as a component of net periodic pension cost:				
Net actuarial loss		**1,690**		10,226
Prior service cost		**80**		186
Net transition obligation		**406**		494
	$	**2,176**	$	10,906

(Thousands of Dollars)

8. Retirement Plans (continued)

	2007	2006
Components of net pension benefit cost:		
Service cost	**$ 1,001**	$ 3,813
Interest cost	**6,688**	6,897
Expected return on assets	**(7,313)**	(6,324)
Recognized actuarial loss	**–**	991
Amortization of unrecognized prior service cost	**106**	143
Amortization of unrecognized net asset	**87**	87
Amortization of unrecognized net loss	**483**	1,877
Curtailment loss	**–**	153
Net periodic pension cost	**$ 1,052**	$ 7,637
Plan year-end measurement dates:		
Clarian Health	**December 31, 2007**	December 31, 2006
LaPorte	**November 30, 2007**	November 30, 2006
Weighted-average actuarial assumptions:		
Discount rate for net periodic pension cost	**5.75%**	5.54%
Discount rate for benefit obligations	**6.24%**	5.75%
Expected rate of return on plan assets	**8.25%**	8.25%
Rate of compensation increase	**4.25%**	4.25%
Accumulated benefit obligation	**$ (110,992)**	$ (116,382)
Accumulated benefit obligations exceeding fair value of plan assets	**$ (17,251)**	$ (27,495)

Expected future benefit payments:	
Fiscal Year:	
2008	$ 5,214
2009	10,481
2010	7,331
2011	10,906
2012 – 2015	52,456

(Thousands of Dollars)

8. Retirement Plans (continued)

Accumulated adjustments to unrestricted net assets at December 31, 2007 include amounts related to net actuarial loss, prior service costs, and transition obligations that have not yet been recognized in net pension benefit cost. Expected amortization of amounts currently in unrestricted net assets will increase net periodic pension costs by $534 during the year ended December 31, 2008.

The principal long-term determinant of a plan's investment return is its asset allocation. The plans' allocations are heavily weighted towards equity assets versus other investments. The expected long-term rate of return assumption is based on the mix of assets in the plans, the long-term earnings expected to be associated with each asset class, and the additional return expected through active management. These assumptions are periodically benchmarked against peer plans.

The weighted-average asset allocations of the plans at December 31, by asset category, are as follows:

Asset category	**2007**	**2006**
Equity and equity-like securities	**64%**	47%
Debt securities	**28**	17
Absolute return strategy (fund of funds)	**7**	7
Cash and cash equivalents	**1**	29
	100%	100%

The allocation strategy for the plans currently comprises approximately 50% to 85% equity investments and 15% to 50% fixed-income investments. The largest component of these equity and equity-like instruments is public equity securities that are diversified and invested in U.S. and international companies.

9. Related Party and Certain Other Strategic Transactions

Indiana University School of Medicine

The Consolidation Agreement requires that Clarian Health fund salaries and related employee benefit costs for medical doctor interns and residents of the School of Medicine who provide services at Clarian Health's facilities. Clarian Health's Board annually reviews and determines the level of support to the School of Medicine for these programs and the number of internships and residencies to be supported by Clarian Health. These costs totaled $33,554 and $26,848 in 2007 and 2006, respectively, and have been reported with salaries, wages, and benefits expense in the accompanying consolidated statements of operations and changes in net assets.

The Consolidation Agreement also provides for additional support to the School of Medicine through a revenue sharing agreement to recognize, as a result of the consolidation, the enhanced and increased level of services being provided, including services to the medically indigent through medical education and research. Annually (or more often), an appointed committee consisting of representatives of Clarian Health, Methodist Health Group, Inc., and Indiana University determines the amount of such additional support to be provided to the School of Medicine, including indirect support to the School of Medicines' medical education activities. During 2007 and 2006, Clarian Health expensed $192,109 and $82,845, respectively, related to support for the School of Medicine, of which $4,000 and $16,096 was unpaid at December 31, 2007 and 2006, respectively. Payments have been classified in the accompanying consolidated statements of operations and changes in net assets with supplies, drugs, purchased services, and other.

Clarian Health purchases services from the School of Medicine. These expenses, principally for medical care case management services, utilities, laboratory services, and other services, totaled $20,904 and $18,859 for the years ended December 31, 2007 and 2006, respectively, and have been reported with supplies, drugs, purchased services, and other expenses in the accompanying consolidated statements of operations and changes in net assets. Clarian Health also provided financial subsidies to I.U. Medical Group – Primary Care, consisting primarily of physicians employed by the School of Medicine, totaling $1,110 and $1,352, respectively, for the years ended December 31, 2007 and 2006.

9. Related Party and Certain Other Strategic Transactions (continued)

Joint Venture Hospitals

In 2004 and 2005, Clarian Health completed the development and construction of two hospitals and related medical office buildings located in the western and northern suburban areas of metropolitan Indianapolis, Indiana. During 2006, Clarian Health formed Arnett-Clarian Health System, LLC (CAHS) and entered into a Definitive Agreement with Arnett Clinic, LLC and its affiliates, a multi-specialty physician clinic, to jointly own and operate a hospital, physician clinics, and other health care facilities in Lafayette, Indiana. The hospital is currently under construction, and the estimated cost of the project is approximately $230,000. In addition, a loan of $10,000 has been made to Arnett Clinic, LLC for development of an ambulatory surgery center which commenced operations in June 2006. The revenues for Arnett Clinic, LLC were $120,867 and $125,824 for the years ended December 31, 2007 and 2006, respectively, and the expenses were $134,276 and $133,748 for the years ended December 31, 2007 and 2006, respectively, exclusive of revenues and expenses of a managed care health maintenance organization which was sold in 2007.

Limited liability companies were formed by Clarian Health for the ownership and operation of the hospitals and medical office buildings. Through the issuance of private placement memorandums, membership interests in these companies have been (or, in the case of CAHS, will be) sold to individual physicians and physician-group practices meeting certain eligibility requirements. The terms of the offerings for the hospital joint ventures stipulate that Clarian Health will hold not less than 60% of the membership interests in these companies owning and operating the joint venture hospitals. However, Clarian Health's membership interests in the companies owning and operating any related medical office buildings is not stipulated and could be less than 50%, dependent on the extent of participation in ownership by the physicians and physician-group practices.

The governance and management responsibilities of the companies have been (or, in the case of CAHS, will be) transferred by Clarian Health to the respective governing bodies of the hospital and medical office building. Representation on the governing bodies of each of the companies approximates the percentage of the members' ownership interests.

Start-up, organization, and development costs aggregated $4,718 and $1,955 during the years ended December 31, 2007 and 2006, respectively, and have been charged to operations.

(Thousands of Dollars)

9. Related Party and Certain Other Strategic Transactions (continued)

The Suburban Facilities have been financed through the capital contributions of the members and borrowings from Clarian Health. Amounts borrowed from Clarian Health are payable on a long-term basis and at fixed interest rates. At December 31, 2007 and 2006, capital contributions by the members aggregated $21,617 and $21,678, respectively, of which approximately $15,070 related to interests held by Clarian Health. Minority interests in the operating losses are limited to the minority interests' capital contributions which have since been exceeded by their proportionate share of the operating losses. Accordingly, Clarian Health has recognized all subsequent losses. Summarized financial information for Clarian West and Clarian North is as follows as of and for the years ended December 31, 2007 and 2006:

	2007	2006
Current assets	**$ 45,735**	$ 39,421
Property and equipment, net	**358,455**	367,406
Other assets	**3,977**	1,803
Total assets	**$ 408,167**	$ 408,630
Current liabilities	**$ 27,604**	$ 18,355
Notes payable to Clarian Health	**465,996**	465,210
Other noncurrent liabilities	**825**	167
Members' deficit	**(86,258)**	(75,102)
Total liabilities and members' deficit	**$ 408,167**	$ 408,630
Operating revenue	**$ 248,184**	$ 186,211
Operating expenses	**260,182**	224,379
Operating loss	**(11,998)**	(38,168)
Start-up, organization, and development costs	**-**	714
Net operating loss	**(11,998)**	(38,882)
Other	**838**	301
Net loss	**$ (11,160)**	$ (38,581)

9. Related Party and Certain Other Strategic Transactions (continued)

Related Foundations

Methodist Health Foundation, Inc. and Riley Children's Foundation are tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code and are organized primarily to provide support to indigent and other patient care programs, fund medical education and research activities, and engage in fundraising activities, a substantial portion of which is on behalf of, or for, specific health care activities of Clarian Health. The financial statements of these foundations are not included in the consolidated financial statements. The interest in net assets of these related foundations is included with other assets and net assets in the accompanying consolidated balance sheets and amounted to $70,311 and $64,444 at December 31, 2007 and 2006, respectively, in accordance with SFAS No. 136. The consolidated net assets include unrestricted support, provided by Riley Children's Foundation, of $12,000 and $2,000 for the years ended December 31, 2007 and 2006, respectively, including $10,000 for the year ended December 31, 2007 for the Riley bed tower. Other changes in the net assets of these foundations are generally reflected with temporarily and permanently restricted net assets.

Other Equity Interest Ventures

In the accompanying consolidated financial statements, Clarian Health has recorded its equity in the income of its unconsolidated subsidiaries which provide health related services with other operating revenue totaling $17,904 and $16,851 for the years ended December 31, 2007 and 2006, respectively.

Clarian Health holds an 87% ownership interest in The HealthCare Group, LLC (THCG). THCG's wholly owned subsidiary, The M•Plan, is a licensed health maintenance organization (HMO) that provides coverage to enrolled members throughout the state of Indiana. The risk of loss for health care coverage provided to members is generally required to be borne by those health care providers that have entered into managed care contracts with The M•Plan. Clarian Health participates jointly with the other owners of THCG in the management and oversight of THCG. However, the minority membership owners of THCG have significant participatory rights; accordingly, Clarian Health accounts for its investment in THCG using the equity method of accounting.

During September 2007, THCG announced that The M•Plan was exiting the business of providing health care coverage effective December 31, 2007, and would wind down its operations during 2008 and 2009. Clarian Health's share of the estimated net costs and expenses

(Thousands of Dollars)

9. Related Party and Certain Other Strategic Transactions (continued)

of the wind down (including severance and termination payments to employees and write-down of property and equipment) approximated $8,200 and has been included with the equity in the income of unconsolidated health care related subsidiaries, which is classified as other operating revenue in the accompanying consolidated statements of operations and changes in net assets.

Payments to THCG for health care benefits relating to Clarian Health employees who have chosen The M•Plan products were $61,105 and $45,890 for the years ended December 31, 2007 and 2006, respectively. Member premium payments to Methodist Medical Group (MMG) from THCG amounted to $226,413 and $220,970 for the years ended December 31, 2007 and 2006, respectively. Additionally, MMG has a receivable from THCG of $1,372 and $104 for the years ended December 31, 2007 and 2006, respectively.

Clarian Health has a 50% membership interest in Midwest Proton Radiotherapy Institute, LLC (MPRI), a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code. MPRI is a cancer treatment and diagnostic clinic located in Bloomington, Indiana. Clarian Health has guaranteed 50% of a $1,700 line of credit borrowing by MPRI. No accrual relating to this guarantee is reflected in the consolidated financial statements.

Clarian Health has a 50% membership interest in MDWise, Inc., a tax-exempt organization under Section 501(c)(4) of the Internal Revenue Code, which holds an HMO license and manages a network of health care providers serving Medicaid patients through the state of Indiana's Medicaid managed care program. Included in prepaid expenses at December 31, 2007, and 2006 is $4,437 and $6,000, respectively, representing prepayments to MDWise, Inc. of future administrative fees. The M•Plan provides administrative and health claims payment processing for these networks, including Carewise, a division of Clarian Health.

Clarian Health and its subsidiaries also have joint venture arrangements for the operation of ambulatory surgery centers, a long-term rehabilitative care hospital, and cancer treatment and diagnostic clinics.

Summarized financial information for THCG, MDWise, Inc., the ambulatory surgery centers, rehabilitative hospital, and cancer treatment and diagnostic clinics as of and for the years ended December 31 as reported by the respective entities:

	2007	2006
Net assets	**$ 105,709**	$ 87,458
Total revenue	**1,264,698**	699,760
Net income	**43,788**	32,047

10. Guarantees and Other

Clarian Health has guaranteed with its joint venture partner a portion of the long-term debt of the rehabilitative care hospital aggregating approximately $7,799 and $7,927 at December 31, 2007 and 2006, respectively.

Clarian Health and its subsidiaries have guaranteed two loans to outside entities aggregating approximately $51 and $651 at December 31, 2007 and 2006, respectively. No accrual related to these guarantees is reflected in the consolidated financial statements. At December 31, 2007 and 2006, respectively, the unpaid balance remaining on these loans was $51 and $351.

Clarian Health and its subsidiaries also have agreements with physician groups and others that guarantee minimum revenue totals. Accruals are made periodically for any minimum revenue guarantee and aggregated $825 at December 31, 2007.

Cash and cash equivalents held and managed by Clarian Health on behalf of organizations that are not consolidated (principally consisting of cash accounts for The M•Plan) aggregated $60,210 and $32,024 at December 31, 2007 and 2006, respectively, and are included with accounts payable and accrued expenses.

11. Health Care Legislation and Regulation

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, Medicare and Medicaid fraud and abuse, and security, privacy, and standards of health information. Government activity has continued with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and noncompliance with regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, significant repayments for patient services previously billed, and disruptions or delays in processing administrative transactions, including the adjudication of claims and payment.

In the opinion of management, there are no known regulatory inquiries which are expected to have a material adverse effect on the consolidated financial statements of Clarian Health; however, compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

ASSURANCE AND ADVISORY
BUSINESS SERVICES

ERNST & YOUNG

ERNST & YOUNG LLP